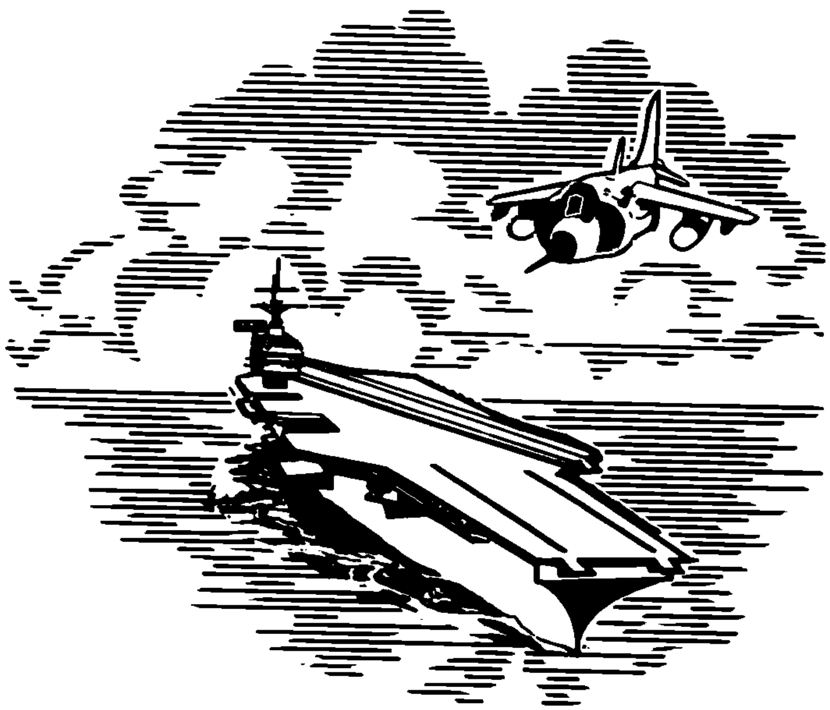
Naval Audit Service
NAVAUDSVC P-7520.1

Draft Audit Report



Fiscal Year 2000 Naval Shipyard Financial Accounting Performed by Defense Finance and Accounting Service Norfolk

2000-0027 **20 December 2000**

Releasable outside the Department of Defense only on approval of the Auditor General of the Navy

Enclosure (1)

DEPARTMENT OF THE NAVY
NAVAL AUDIT SERVICE
1006 BEATTY PLACE SE
WASHINGTON NAVY YARD, DC 20374-5005

7547/2000-0027
MCV-LNB
20 Dec 2000

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Subj **FISCAL YEAR 2000 NAVAL SHIPYARD FINANCIAL ACCOUNTING PERFORMED BY DEFENSE FINANCE AND ACCOUNTING SERVICE NORFOLK (2000-0027)**

Ref: (a) Public Law 101-576, "Chief Financial Officers Act," 15 Nov 90 as amended by Public Law 103-356, "Government Management Reform Act of 1994"
(b) SECNAV Instruction 7510.7E, "Department of the Navy Internal Audit"

Encl: (1) Draft of Subject Report

1. We have completed the subject audit in accordance with reference (a) and in support of the Inspector General, Department of Defense. Audit results were discussed with the designated representatives within the Department of Defense.

2. Section A of this report identifies audit results and provides recommendations to improve financial management. In accordance with reference (b), the Director, Defense Finance and Accounting Service should provide written responses to the recommendations within 30 days of the date of this letter. The responses should specify concurrence or nonconcurrence with the recommendations. Concurrence should describe appropriate corrective actions and provide target completion dates. Nonconcurrences should explain the reasons for disagreement.

3. This report will be transmitted via the Inspector General, Department of Defense, as requested by the Inspector General.

4. If you have any questions, please contact Mel Vineyard, the Audit Project Manager for this audit, at 202-433-6310 (DSN 288-6310) or email vineyard.melvin@hq.navy.mil.

5. We appreciate the cooperation and courtesies extended to our auditors.

BILL A. RODERICK
Assistant Auditor General
Financial and Forces Management Audits

Subj: **FISCAL YEAR 2000 NAVAL SHIPYARD FINANCIAL ACCOUNTING PERFORMED BY DEFENSE FINANCE AND ACCOUNTING SERVICE NORFOLK (2000-0027)**

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Table of Contents

Executive Summary

Purpose of Audit

This report conveys summary information regarding our audit of Fiscal Year 2000 financial accounting for the three active Naval Shipyards - Norfolk, Portsmouth, and Puget Sound - performed by Defense Finance and Accounting Service Norfolk. The audit was accomplished in support of the Inspector General, Department of Defense and sought to determine adequacy of internal controls and compliance with laws and regulations.

Results of Audit Work

Significant financial internal controls used for Naval Shipyard financial reporting were unreliable, resulting in a high audit risk assessment. The internal controls and financial operating procedures contained material weaknesses and reportable conditions, which increased the risk of errors and material misstatements in the financial statements. The deficiencies included the lack of a compliant financial management system, improper journal voucher processing, inconsistent and incomplete operating procedures, and lack of valid Memorandums of Agreement between the Naval Shipyards and the Defense Finance and Accounting Service. The deficiencies generally represented noncompliance with Department of Defense guidance and other regulations, and were generally due to problems with implementing a new financial management system, confusion about roles and responsibilities, and the absence or failure of control processes and procedures.

Because there were unreliable financial controls, we have no assurance that information submitted to Defense Finance and Accounting Service Cleveland Center was accurate, complete, and timely, or whether adjustments made by Defense Finance and Accounting Service Norfolk to Shipyard data were accurate, correct, supported, complete, and timely.

Corrective Actions

We made various recommendations to correct the internal control deficiencies found. These recommendations were made to the Defense Finance and Accounting Service who provides accounting services for the active Naval Shipyards.

Section A
Results of Audit Work

Finding 1
Financial Management System

As of 30 September 2000, Naval Shipyard financial accounting did not have a compliant and integrated General Ledger financial management system as required by public law and other implementing regulations. The Defense Finance and Accounting Service (DFAS) is responsible for implementing and maintaining such General Ledger financial management systems for Department of Defense activities. DFAS had intended to implement a commercial accounting system by the end of Fiscal Year 2000, but encountered problems. Additionally, efforts were suspended because Naval Sea Systems Command planned to make changes to the Shipyard Management Information System (SYMIS). The lack of a compliant financial accounting system necessitated work-arounds and unnecessary duplication of transaction entries in order to prepare and report financial data. These manual processes can result in errors in financial data; are an inefficient use of resources; and increase the risk for inaccurate Department of the Navy Working Capital Fund financial reports.

Background and Pertinent Guidance

Public Law. The Federal Financial Management Improvement Act of 1996 required agencies to implement and maintain financial management systems that comply with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government General Ledger at the transaction level. For purposes of this Act, a Federal accounting system should satisfy the United States Government Standard General Ledger as approved by the Department of the Treasury, the Office of Management and Budget (OMB), and the General Accounting Office. Using standard general ledgers ensures that all government entities and institutions account for similar activities in the same way and consistently from one fiscal year to the next. Accounting systems would be supported by feeder systems, which could also support other management requirements.

OMB Requirements. OMB Circular No. A-127 prescribes financial management system policies and standards and requires federal agencies, including military departments, to establish and maintain single, integrated financial management systems. Generally, financial management systems include unified sets of financial systems and the financial portions of mixed systems.

Joint Financial Management Improvement Program. OMB Circular No. A-127 and the "Framework for Federal Financial Management Systems" published by the Joint Financial Management Improvement Program require that financial systems be designed to eliminate unnecessary duplication of transaction entry. Data needed by the systems to support financial functions should be entered only once and other parts of the system should be updated through electronic means. Further, they define a "single, integrated financial system" as a unified set of financial systems to carry out financial management functions and reporting requirements. The term "unified" means that the systems are operated in an integrated fashion and linked together electronically in an efficient and effective manner.

Department of Defense Guidance. Financial management requirements, contained in the Department of Defense Financial Management Regulation (DOD 7000.14-R), Volume 1, Chapter 2, states DFAS is responsible for operating and maintaining a central double entry General Ledger system. The purpose of the system is to account for resources assigned to each Department of Defense Component, to determine the costs of their operations, and to report on their financial position and cost of operations. The central General Ledger and its Subsidiary Ledgers should serve as the source for financial reporting requirements. Accounting systems and subsystems or modules should be fully integrated with the central General Ledger. System processing requirements include the use of electronic methods of processing, communicating, and displaying data.

Discussion of Details

Shipyard Accounting. We reviewed Naval Shipyard financial accounting performed by the DFAS Norfolk, as shown in Exhibit C. As of 30 September 2000, DFAS did not have a compliant and integrated General Ledger financial management system for Naval Shipyard financial accounting. Shipyard financial accounting information was received through the Shipyard Management Information System (SYMIS), as well as by FAX and electronic mail. The Naval Sea Systems Command developed SYMIS for Shipyard financial accounting, but an automated General Ledger was never developed. Information received using SYMIS was manually compiled and entered into the financial records via spreadsheets. Separate spreadsheets to manually record the General Ledger data were used and continued in use when DFAS Norfolk assumed the Naval Shipyard's financial accounting.

Reason for Deferring Improvements. DFAS had initiated action to improve Naval Shipyard financial accounting, which focused on the General Ledger financial management system. DFAS had purchased a commercial accounting system in March 1999 and was going to implement it by the end of Fiscal Year

2000 for the Naval Shipyard's General Ledger. However, testing by DFAS Norfolk found that the commercial accounting system did not meet the needs for Naval Shipyard financial accounting. The system was not robust enough and produced distorted financial data. Further, the effort was suspended because the Naval Sea Systems Command was to make changes to SYMIS for Fiscal Year 2001, adding a General Ledger component and making it compliant with the United States Government Standard General Ledger.

SYMIS was owned by the Navy and used by DFAS to prepare the Naval Shipyards' financial reports. SYMIS does not have subsidiary and General Ledger account applications. Assuming no delays, full implementation of the SYMIS upgrades was not expected to be completed until June 2001. In the interim, the current accounting method remains noncompliant and inadequate, and represents a material internal control weakness as defined by OMB guidance and Department of Defense regulation. Regardless of initiatives undertaken by other commands, DFAS is still responsible for implementing compliant General Ledger financial management systems as required by OMB guidance and other regulations. Implementation of an integrated, compliant system would greatly improve and streamline accounting operations.

Impact on Financial Reporting. In the absence of an electronic transaction-driven, general ledger accounting system, work-arounds and redundant, time- and labor-intensive manual processes were needed in order to prepare and report financial information. There was unnecessary duplication of transaction entries, no interface between accounting systems, redundant manual processes, and an inefficient use of resources. The monthly preparation of financial information entails a manual download of the SYMIS accounts into a spreadsheet for posting into the correct General Ledger Accounts. The financial information is then entered manually into the Department of the Navy Industrial Budget Information System (DONIBIS). DONIBIS is the system used within the Navy Working Capital Fund to transmit financial data among the various activities and accounting offices. The U.S. Government Standard General Ledger is not used in either SYMIS or DONIBIS.

An example of the manual processes needed is the one DFAS Norfolk, Puget Sound Naval Shipyard Accounting Branch, Code AASB accounting technicians have to perform to determine and report the month end balance for Accounts Payable – Federal (General Ledger Account 2110):

1. Post journal vouchers and entries to the General Ledger (Excel Spreadsheet);
2. Prepare the Trial Balance from the General Ledger;
3. Post the Trial Balance to another Excel spreadsheet;

4. This data is used to prepare the financial report drafts;
5. The data is entered to a file used to generate the DONIBIS;
6. Then, the DONIBIS is copied to a disk; and
7. The Management Information System group transmits the data to DFAS Cleveland Center and Naval Sea Systems Command via DONIBIS.

Ultimately, manual processes can result in errors in financial data; are an inefficient use of resources; and increase the risk for inaccurate Department of the Navy Working Capital Fund financial reports.

Recommendation

1. We recommend that the Director, Defense Finance and Accounting Service develop, implement, and maintain a financial management system for Naval Shipyard General Ledger accounting that substantially complies with the legal and regulatory Federal financial management system requirements and accounting standards.

Finding 2

Journal Voucher Processing

DFAS Norfolk had not properly processed journal vouchers used in preparation of the three active Naval Shipyards' - Norfolk, Portsmouth, and Puget Sound - financial statements, contrary to Department of Defense guidance. Specifically, DFAS Norfolk had not obtained sufficient journal voucher support that provided a clear audit trail to the source of transactions. DFAS Norfolk personnel stated that Shipyard personnel prepared journal vouchers and forwarded them to DFAS to be entered into the accounting system. Therefore, DFAS Norfolk personnel felt that Shipyard personnel should retain appropriate support. As a result, the Naval Shipyards' financial reports for the period ending 31 March 2000 were potentially unsupportable.

Background and Pertinent Guidance

Department of Defense Guidance. The Department of Defense Financial Management Regulation, DOD 7000.14-R, Volume 6, Chapter 2, requires the Director, DFAS to establish procedures that ensure the process for preparing financial reports is consistent, timely, and auditable. Also, internal controls should be adequate to ensure that DFAS-prepared reports are supportable, reliable, and accurate. The Regulation also requires that DFAS ensure that a complete and documented audit trail is maintained to support the reports prepared.

Department of Defense Financial Management Regulation Volume 1, Chapter 3, Key Accounting Requirement Number 8, Audit Trails, states that all transactions, including those which are computer-generated and computer-processed, must be traceable to individual source records. Items in source records necessary for audit-trail purposes include transaction type, record or account involved, amount, processing references, and identification of the preparer and approver of the transaction.

Department of Defense Financial Management Regulation, Volume 4, Chapter 1, Paragraph 0103 requires that cash receipts and disbursements are to be reconciled with appropriate documents and accounting records, as applicable within each accounting period.

DFAS Guidance. The Director, DFAS issued Journal Voucher Guidance in a 2 August 2000 Memorandum for Directors, DFAS Centers. The memorandum provided guidance on the use of journal vouchers within the Department of Defense. The guidance states proper preparation of journal vouchers is important to ensure that documentation for a detailed audit trail exists and that journal vouchers are accurately recorded as financial events. These procedures apply to all DFAS Centers and Operating Locations.

Discussion of Details

Journal Voucher Processing. Journal vouchers used to support and prepare the three active Naval Shipyards' financial statements were not always processed correctly. Journal voucher accounting and reporting procedures and internal controls were insufficient and not working as intended. Specifically, DFAS Norfolk had not obtained sufficient journal voucher support that provided a clear audit trail to the source of transactions. We also noted that DFAS Norfolk had not made certain that journal vouchers were properly signed and approved; ensured an adequate separation of duties; and clarified the division of responsibilities between the Shipyards and DFAS Norfolk.

We reviewed every journal voucher, 121 journal voucher transactions, valued at $5.2 billion, that DFAS Norfolk personnel posted to the Norfolk, Portsmouth and Puget Sound Naval Shipyards' 31 March 2000 General Ledgers. These journal vouchers were prepared for various purposes including, among others, revenue recognition, fixed asset disposals and acquisitions, monthly reversing entries, military and civilian payroll, monthly purchase register, and posting error corrections. We assessed the sufficiency of journal voucher support and the adequacy of audit trails. We examined the journal vouchers for proper authorization and approval, and for appropriate separation of duties. We evaluated internal controls over journal voucher processing, and assessed compliance with pertinent laws and regulations.

Journal Voucher Support. We found 44 ($3.1 billion) of the 121 ($5.2 billion) journal voucher transactions processed for the Naval Shipyards' 31 March 2000 financial statements by DFAS Norfolk were unsupported and did not have adequate audit trails. These deficiencies existed, primarily, because DFAS Norfolk had not required the Shipyards to forward journal voucher support and had not maintained support to provide a clear audit trail for these transactions. Our review found the following:

- Only partial support was available for 27 journal vouchers valued at $2.2 billion. Records indicated support documentation was located at the Shipyards. Computer-generated reports or a spreadsheet prepared by the Shipyards were provided as support for these journal vouchers, but the support was not complete in all aspects. DFAS Norfolk had not obtained sufficient support that provided a clear audit trail. We could not verify the accuracy of the journal vouchers. The scope of our audit was limited to DFAS Norfolk and we did not review the supporting documentation maintained at the Shipyards.

- Support was missing for 15 journal vouchers valued at $575.2 million. The transactions were posted to the general ledger based solely on the journal vouchers. Additionally, DFAS Norfolk did not have backup for all reversing journal voucher transactions.

- Two journal voucher transactions, valued at $309.2 million, were based on an unsupported computation. DFAS Norfolk matched Shipyard activity cash balances with DFAS-Cleveland Center's Activity Control Ledger. In accordance with Department of Defense Comptroller policy, the Shipyard activity cash balances were adjusted to be in agreement with Fiscal Year to Date reimbursements and disbursements reflected on the Navy Working Capital Fund Activity Control Ledger. Although DFAS Norfolk was complying with the policy, a true reconciliation between activity cash and Treasury cash was not performed. Therefore, we considered these journal voucher transactions as adjustment "plug" figures, prepared mainly for balancing purposes.

Reasons for Not Maintaining Support. DFAS Norfolk personnel stated that Shipyard personnel prepared journal vouchers and forwarded them to DFAS to be entered into the accounting system. For that reason, DFAS Norfolk personnel felt that Shipyard personnel should retain appropriate support.

As stated in the causes above, personnel preparing journal vouchers at the Shipyards should retain the detailed transaction level supporting documents for journal vouchers they prepare. However, DFAS guidance and prudent accounting practices require that DFAS locations should obtain sufficient support to clearly understand the reason for preparing journal vouchers and attach that support to the vouchers. In cases where it is not practical to attach all documents supporting journal vouchers, specific and detailed instructions concerning the content and location of supporting documents should be retained. Inadequate supporting documentation and insufficient audit trails represent a material internal control deficiency as defined by OMB guidance and Department of Defense regulation.

Other Issues. We also noted the following miscellaneous issues connected with journal processing:

- Not all journal vouchers were properly signed. Signatures in the "prepared by" and "approved by" columns of some journal vouchers were missing.

- A few journal vouchers were prepared and approved by the same person.

- The division of responsibility between Norfolk Naval Shipyard and DFAS Norfolk was not clear. Norfolk Naval Shipyard personnel prepared all journal vouchers, although DFAS Norfolk personnel provided the information for the journal vouchers.

Based on details that we provided to management, DFAS Norfolk initiated action to correct the identified deficiencies.

Impact. Journal vouchers have a significant impact on general ledger balances and financial reports. Processing and recording journal vouchers correctly is important to ensure reliable and accurate financial reporting. Because of inadequate controls over journal voucher processing and inadequate supporting data, Shipyard financial reports were potentially unsupportable.

Recommendations

We recommend that the Director, Defense Finance and Accounting Service:

2. Obtain from the Naval Shipyards and retain on file the documentation needed to support all journal vouchers as required by the Defense Finance and Accounting Service Journal Voucher Guidance issued 2 August 2000.

3. Establish journal voucher processing procedures for Naval Shipyard financial accounting, as needed to comply with the Journal Voucher Guidance issued by Defense Finance and Accounting Service on 2 August 2000.

4. Establish cash reconciliation procedures for Naval Shipyard financial accounting as required by the Department of Defense Financial Management Regulation Volume 4, Chapter 1, Paragraph 0103.

Finding 3

Operating Procedures

DFAS Norfolk had not established consistent and complete operating procedures for the three Naval Shipyard Accounting Branches in accordance with public law and implementing regulations. Specifically, superceded guidance was still in use, two of the three accounting branches did not have desktop procedures, and finance and accounting practices and procedures were inconsistent among the branches. DFAS Norfolk management stated they had not created or updated operating procedures because finance and accounting business practices had been changing over the past few years. Also, DFAS Norfolk personnel assigned higher priority to performing required finance and accounting functions rather than to documenting the procedures. These deficiencies increased the risk of errors and material misstatements in the Naval Shipyards' financial statements.

Background and Pertinent Guidance

The Federal Managers' Financial Integrity Act of 1982 requires Federal agencies to implement internal accounting and administrative controls that comply with standards established by the Comptroller General. The objective of an internal control structure is to provide management with reasonable assurance that: (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenue and expenditures applicable to agency operations are properly recorded and accounted for. DFAS Norfolk is responsible for establishing and maintaining an internal accounting control structure that complies with these requirements.

Financial accounting standards, contained in the Department of Defense Financial Management Regulation (DOD 7000.14-R), Volume 1, Paragraph 030602 and the Codification of Statements on Auditing Standards, define a material weakness as a condition for which the design or operation of the internal control does not reduce to a low level the risk that errors or irregularities would be material in relation to the financial statements being audited. A weak internal control structure will not prevent or detect within a timely period an error or misstatement in the financial records or financial statements. DOD 7000.14-R provides various financial management requirements.

Discussion of Details

Consistent and complete operating procedures had not been established for the three Naval Shipyard Accounting Branches. As required by public laws and implementing regulations, DFAS Norfolk is responsible for implementing an adequate system of management controls to include documented operating procedures.

We reviewed operating procedures used by the three Naval Shipyard Accounting Branches at DFAS Norfolk for preparation of Naval Shipyard financial data. We prepared transaction cycle memorandums and flowcharts describing the accounts and the financial transaction processes that we reviewed. We found operating procedures did not exist, were inconsistent, and/or were incomplete for the three Naval Shipyard Accounting Branches:

Financial criteria: DFAS Norfolk Shipyard Supervisors were citing the Navy Comptroller (NAVCOMPT) Manual as criteria instead of the Financial Management Regulation. The NAVCOMPT Manual was superceded by the Department of Defense Financial Management Regulation (DOD 7000.14-R), which established Department of Defense financial management policies and procedures. Managers stated that the NAVCOMPT Manual provided more complete guidance and forms than the Financial Management Regulation. Nevertheless, the Financial Management Regulation cites the accounting principles, standards, and related requirements, which govern financial management by establishing and enforcing requirements, principles, standards, and regulatory requirements applicable to the Department of Defense. It directs financial management requirements, systems, and functions for all appropriated, non-appropriated, working capital, revolving, and trust fund activities. In addition, it directs statutory and regulatory financial reporting requirements. The use of out-of-date criteria by DFAS Norfolk Shipyard Supervisors increased the risk those inaccurate and out-of-date policies and procedures could be used thus leading to inaccurate and unreliable financial statements. As stated in the Financial Management Regulation, DFAS Norfolk managers should submit suggestions for improvement of the guidance to the Office of the Under Secretary of Defense (Comptroller), Director for Accounting Policy.

Desktop procedures: Desktop procedures were non-existent at two of the three Naval Shipyard Accounting Branches at DFAS Norfolk. The November 1999 Standards for Internal Control in the Federal Government (GAO/AIMD-00-21.3.1) states internal controls and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained. Desktop procedures are an internal control and should be clearly documented. They help to define internal controls and ensure employees are made aware of those controls. The lack of desktop procedures increased the risk of inaccuracy and incomplete financial data.

Finance and accounting practices and procedures: Finance and accounting practices and procedures for the DFAS Norfolk Naval Shipyard Accounting Branches were not the same for each Naval Shipyard. We noted in our transaction cycle memorandums prepared for this review, that while generally procedures were similar for each of the three Naval Shipyard Accounting Branches, there were differences. The branches were using various combinations of different software programs to access, account, and report monthly financial information. Financial information was manually inputted into reports using data obtained. Without standard practices and procedures, Naval Shipyard financial statements were at risk of lacking comparability, containing errors and misstatements and being unreliable financial statements. Standard business practices ensure efficiency and consistency in performing tasks, ease training others in the task at hand, allow employees from one branch to perform similar tasks for another, and ensure comparability of the Naval Shipyard financial data.

Reasons for Not Documenting Procedures. Management stated they had not created or updated operating procedures because finance and accounting business practices had been changing over the past few years. Also, DFAS Norfolk personnel assigned higher priority to performing required finance and accounting functions rather than to documenting the procedures.

Maintaining and documenting current procedures and practices is even more important during periods of change than during periods of stability. Current guidance requires financial managers to develop and implement processes to ensure adequate accounting control and to ensure accurate financial reporting. Promulgating standard procedures based on current criteria will greatly reduce the risk of error and inconsistency in financial records. Providing the accounting staff with current, accurate operating procedures will streamline accounting functions and permit more efficient performance of core functions. The absence of consistent and complete operating procedures as required by public laws and implementing regulations represents a material internal control deficiency as defined by OMB guidance and Department of Defense regulation.

Recommendations

We recommend that the Director, Defense Finance and Accounting Service:

5. Develop and implement procedures that ensure the three Naval Shipyard Accounting Branches use the Financial Management Regulation (DOD 7000.14-R) for operating policies and procedures.

6. Develop and implement Naval Shipyard financial accounting desktop procedures.

7. Develop and implement standard finance and accounting practices and procedures for the three Naval Shipyard Accounting Branches, including how to submit suggestions for updates and improvement of the Financial Management Regulation to the Office of the Under Secretary of Defense (Comptroller), Director for Accounting Policy.

Finding 4

Roles and Responsibilities

DFAS did not provide Memorandums of Agreement that detailed roles and responsibilities for Naval Shipyard financial accounting between DFAS Norfolk and the Portsmouth, Puget Sound, and Norfolk Naval Shipyards. Valid Memorandums of Agreement, including supporting Concept of Operations, did not exist between DFAS Norfolk and the Naval Shipyards. Managers at DFAS Cleveland and DFAS Headquarters stated they were aware of requirements identified in Department of Defense Instruction 4000.19. However, managers stated that Memorandums of Agreement for the three Shipyards did not exist and were not required because the rates for support (accounting services) are non-negotiable. As a result, accountability and determination of who was responsible for Naval Shipyard accounting functions could not be determined in all cases thereby increasing inherent risk that errors could occur.

Background and Pertinent Guidance

Department of Defense Instruction 4000.19, Interservice and Intragovernmental Support, requires that interservice and intragovernmental support arrangements should be evidenced by written agreements. A DD Form 1144, or other similarly formatted document is required for reimbursable support and a Memorandum of Agreement is required for non-reimbursable support. Memorandums of Agreement may also be used for reimbursable support as long as they are supplemented with supporting agreements that contain the same basic information as on the DD Form 1144. DD Forms 1144 define support, basis for reimbursement for each category, billing and payment processes, and other terms and conditions of agreements. Memorandums of Agreement define areas of conditional agreement where actions of one party are dependent on actions of another party.

Discussion of Details

Memorandums of Agreement. DFAS Norfolk and Portsmouth, Puget Sound, and Norfolk Naval Shipyards did not have valid Memorandums of Agreement including Concept of Operations in place as required by Department of Defense Instruction 4000.19. A Concept of Operations establishes responsibilities between DFAS Norfolk and the Shipyards, and is a supplemental support to the Memorandums of Agreement.

Department of Defense regulations require that Memorandums of Agreement setting forth defined roles and responsibilities be established for interservice and intragovernmental support. We requested Memorandums of Agreement and Concepts of Operations to further evaluate internal controls. In our review of the Memorandums of Agreement between DFAS Norfolk and Portsmouth, Puget Sound, and Norfolk Naval Shipyards, we found that valid agreements did not exist. There were signed documents titled "Memorandum of Agreement" between DFAS Norfolk and Portsmouth and Puget Sound Naval Shipyards, but not between DFAS Norfolk and Norfolk Naval Shipyard. Further, the contents of the two Memorandums of Agreement provided were merely a description of the transfer of resources and workload when DFAS Norfolk took over Naval Shipyard financial accounting. They did not define the basis for reimbursement for each category, the billing and payment process, and other terms and conditions usually found in agreements.

Concept of Operations. The Concept of Operations for each of the Shipyards existed, but they were not current or signed and were basically rough drafts. Also, the Concept of Operations for Norfolk Naval Shipyard was missing some of the detail provided in the Portsmouth and Puget Sound Naval Shipyards' Concept of Operations. Because the DFAS Norfolk and Portsmouth, Puget Sound, and Norfolk Naval Shipyards did not have current, signed Memorandums of Agreement including supporting Concept of Operations, we were not able, in all cases, to ascertain who had specific Shipyard financial accounting responsibilities.

Impact. The purpose of these written agreements is to set forth guidance on organizational responsibilities and to evidence an agreement for accountability purposes. A well-controlled organization consists of clearly defined lines of responsibility, authority, and accountability. When roles and responsibilities are not clearly defined, an internal control deficiency exists. This deficiency can affect the achievement of organizational goals and objectives. We consider not having Memorandums of Agreement and supporting Concept of Operations between DFAS Norfolk and the Naval Shipyards an internal control deficiency.

Reasons for Not Maintaining Agreements. Managers at DFAS Cleveland and DFAS Headquarters stated they were aware of requirements identified in Department of Defense Instruction 4000.19. However, managers stated that Memorandums of Agreement for the three Shipyards did not exist and were not required because the rates for support (accounting services) are non-negotiable.

Because Memorandums of Agreement and supporting documentation identify and define organizational roles and responsibilities, these memorandums are necessary whether the rates for accounting services are negotiable or not. Well-defined divisions of responsibility are a critical, basic element of management control. Clarifying roles and responsibility for financial accounting will enhance accountability and improve the overall control environment even if reimbursable rates for accounting support are non-negotiable. The absence of well-defined divisions of responsibility represents a material internal control weakness as defined by OMB guidance and Department of Defense regulation.

Recommendations

We recommend the Director, Defense Finance and Accounting Service:

8. Establish Memorandums of Agreement including the Concept of Operations that delineate specific accountability and responsibility between Portsmouth, Puget Sound, and Norfolk Naval Shipyards and Defense Finance and Accounting Service Norfolk.

9. Establish procedures to periodically review the Memorandums of Agreement, including the Concept of Operations between Portsmouth, Puget Sound, and Norfolk Naval Shipyards and Defense Finance and Accounting Service Norfolk, to ensure they are current, accurate, and in compliance with regulations.

Section B

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS								MONETARY BENEFITS (In $000s)			
[1]Finding	Rec. No.	Page No.	Subject	[2]Status	Action Command	Target Completion Date	[3]Category	Claimed Amount	Agreed To	Not Agreed To	[4]Appropriation
1	1	5	Develop, implement, and maintain a financial management system for Naval Shipyard General Ledger accounting that substantially complies with the legal and regulatory Federal financial management system requirements and accounting standards.		Director, Defense Finance and Accounting Service						
2	2	9	Obtain from the Naval Shipyards and retain on file the documentation needed to support all journal vouchers as required by the Defense Finance and Accounting Service Journal Voucher Guidance issued 2 August 2000.		Director, Defense Finance and Accounting Service						
2	3	9	Establish journal voucher processing procedures for Naval Shipyard financial accounting, as needed to comply with the Journal Voucher Guidance issued by Defense Finance and Accounting Service on 2 August 2000.		Director, Defense Finance and Accounting Service						
2	4	9	Establish cash reconciliation procedures for Naval Shipyard financial accounting as required by the Department of Defense Financial Management Regulation Volume 4, Chapter 1, Paragraph 0103		Director, Defense Finance and Accounting Service						
3	5	13	Develop and implement procedures that ensure the three Naval Shipyard Accounting Branches use the Financial Management Regulation (DOD 7000.14-R) for operating policies and procedures.		Director, Defense Finance and Accounting Service						
3	6	13	Develop and implement Naval Shipyard financial accounting desktop procedures.		Director, Defense Finance and Accounting Service						
3	7	13	Develop and implement standard finance and accounting practices and procedures for the three Naval Shipyard Accounting Branches, including how to submit suggestions for updates and improvement of the Financial Management Regulation to the Office of the Under Secretary of Defense (Comptroller), Director for Accounting Policy.		Director, Defense Finance and Accounting Service						
4	8	16	Establish Memorandums of Agreement including the Concept of Operations that delineates specific accountability and responsibility between Portsmouth, Puget Sound, and Norfolk Naval Shipyards and Defense Finance and Accounting Service Norfolk		Director, Defense Finance and Accounting Service						

1/ + = Indicates repeat finding
2/ O = Recommendation is open; C = Recommendation is closed with all action completed; U = Recommendation is undecided
3/ A = One-time potential funds put to better use; B = Recurring potential funds put to better use for up to 6 years; C = Indeterminable/immeasurable
4/ = Includes appropriation (and subhead if known)

RECOMMENDATIONS								MONETARY BENEFITS (In $000s)			
[1]Find-ing	Rec. No.	Page No.	Subject	[2]Status	Action Command	Target Completion Date	[3]Cate-gory	Claimed Amount	Agreed To	Not Agreed To	[4]Appro-priation
4	9	16	Establish procedures to periodically review the Memorandums of Agreement, including the Concept of Operations between Portsmouth, Puget Sound, and Norfolk Naval Shipyards and Defense Finance and Accounting Service Norfolk to ensure they are current, accurate, and in compliance with regulations		Director, Defense Finance and Accounting Service						

1/ + = Indicates repeat finding
2/ O = Recommendation is open; C = Recommendation is closed with all action completed; U = Recommendation is undecided
3/ A = One-time potential funds put to better use; B = Recurring potential funds put to better use for up to 6 years; C = Indeterminable/immeasurable
4/ = Includes appropriation (and subhead if known)

Exhibit A
Background

Audit Requirement

The audit was performed at the request of the Inspector General, Department of Defense. In support of that request, we completed an audit of the Fiscal Year 2000 Naval Shipyard financial accounting performed by Defense Finance and Accounting Service Norfolk for the Department of the Navy's Working Capital Fund Fiscal Year 2000 financial statements. The review was performed during Fiscal Years 2000 and 2001 and encompassed the accounting principles, standards, and related requirements prescribed by various Public Laws to include: the Chief Financial Officers Act (Public Law 101-576), amended by the Government Performance and Results Act of 1993 (Public Law 103-62); Information Technology Management Reform Act of 1996; and Federal Financial Management Improvement Act of 1996 (Public Law 104-208).

Department of the Navy Working Capital Fund

The Department of Defense established the Defense Business Operations Fund in 1991 to provide industrial and commercial type services at the lowest cost. In Fiscal Year 1996, the Defense Business Operations Fund was reorganized into Working Capital Funds for each service. The Department of the Navy Working Capital Fund is designed for activities that provide services that can be charged to customers, as is done in private industry. There are eight primary activity groups within the Navy Working Capital Fund: Naval Shipyards; Naval Aviation Depots; Other (Marine Corps); Transportation; Base Support; Information Services; Research and Development; and Supply Management. The mission of the Naval Shipyards is to provide logistic support for ships and service craft; to perform construction, overhaul, repair, alteration, dry-docking, and outfitting of ships and craft; to perform design, manufacturing, refit, and restoration; and to provide services and material to other activities and units as required. In Fiscal Year 2000 there were three Naval Shipyards – Portsmouth, NH; Norfolk, VA; and Bremerton, WA. In Fiscal Year 1999 the Naval Shipyards represented 11 per cent ($2.3 billion) of the total Navy Working Capital Fund combined revenues of $21 billion.

Defense Finance and Accounting Service

The Defense Finance and Accounting Service prepares and issues financial statements for Department of the Navy funds, including those of the Department of the Navy Working Capital Fund. The quality of information in these financial statements is a joint responsibility of the Department of the Navy and the Defense Finance and Accounting Service. Department of the Navy management has overall responsibility for the accuracy of financial statement presentation. Department of the Navy financial feeder systems provide the financial performance data needed to prepare and support the financial statements.

Defense Finance and Accounting Service Norfolk

Defense Finance and Accounting Service Norfolk was established in April of Fiscal Year 1995 and is located on Naval Station, Norfolk, VA. Originally established as the Defense Finance and Accounting Service Norfolk Operating Location; the name was changed on 1 October 2000. Defense Finance and Accounting Service Norfolk is the successor activity to the Department of the Navy Fleet Accounting and Disbursing Center – Atlantic. Defense Finance and Accounting Service Norfolk has disbursing and accounting responsibilities for, among others, Department of the Army General and Working Capital Fund activities and Department of the Navy General and Working Capital Fund activities. Active Navy Working Capital Fund activities include the Norfolk, Puget Sound, and Portsmouth Shipyards. Defense Finance and Accounting Service Norfolk reports to Defense Finance and Accounting Service Cleveland.

Exhibit B
Objectives

The objectives of this audit were to determine whether:

- Defense Finance and Accounting Service Norfolk financial accounting system operations and internal controls related to the Naval Shipyard component for Fiscal Year 2000 Department of the Navy Working Capital Fund Consolidated Financial Statements were adequate to ensure accountability; support financial transactions; and detect or prevent errors and misstatements that had a material effect on financial statement balances.

- Defense Finance and Accounting Service Norfolk financial management processes and procedures were adequate to ensure the Naval Shipyard component of the Fiscal Year 2000 Department of the Navy Working Capital Fund Consolidated Financial Statements were in compliance with laws and regulations that had a material effect on the financial statement balances.

- Defense Finance and Accounting Service Norfolk ensured the Naval Shipyard component of the Fiscal Year 2000 Department of the Navy Working Capital Fund Consolidated Financial Statements information submitted to Defense Finance and Accounting Service Cleveland was accurate, complete, and timely.

- The automated and manual adjustments made by Defense Finance and Accounting Service Norfolk to Fiscal Year 2000 financial data received from Naval Shipyards were accurate, correct, supported, complete, and timely.

Exhibit C
Scope and Methodology

This report conveys summary information regarding our audit review of Naval Shipyard financial accounting performed by Defense Finance and Accounting Service Norfolk for the Fiscal Year 2000 Consolidated Financial Statements of the Department of the Navy Working Capital Fund. The audit was accomplished in support of the Inspector General, Department of Defense.

Our audit evaluated the internal controls at Defense Finance and Accounting Service Norfolk. We also reviewed compliance with laws and regulations and consistency in application of Generally Accepted Accounting Principles.

We performed our audit work from 25 April 2000 to 20 December 2000 at the Defense Finance and Accounting Service Norfolk, VA.

As required by the Federal Financial Management Improvement Act of 1996, we reviewed the financial management systems as defined by the Act. The review was performed during Fiscal Years 2000 and 2001 and encompassed the accounting principles, standards, and related requirements prescribed by the Act.

Various methods were used in performing our review. These included use of system analyses, limited transaction testing, and review of operations. Specific deficiencies were brought to the attention of management, which commenced several actions to correct noted deficiencies.

The audit was conducted in accordance with generally accepted government auditing standards, Office of Management and Budget guidance, and the General Accounting Office Financial Auditing Manual. We reviewed applicable laws, policies, procedures, regulations, and directives, as listed in Exhibit D.

In assessing internal controls, auditors are required to gain an understanding of an entity's accounting cycles and related internal controls. Transaction cycle memorandums and complementary flowcharts identify significant cycle and accounting applications and assist the auditor in the assessment. We prepared transaction cycle memorandums and flowcharts describing the accounts and the financial transaction process for the following accounts and sub-accounts for the Fiscal Year 2000 Consolidated Financial Statements of the Department of the Navy Working Capital Fund's Naval Shipyard component:

Assets

Fund Balance with Treasury
Accounts Receivable, Federal
Accounts Receivable, Non-Federal
Operating Materials and Supplies
Property, Plant and Equipment
Assets Under Development

Liabilities

Accounts Payable, Federal
Accounts Payable, Non-Federal
Accrued Liabilities
Military Payroll (part of Accrued Liabilities)
Civilian Payroll (part of Accrued Liabilities)

We examined accounting records and reports, evaluated evidence supporting the financial statements, reviewed accounting procedures and principles used, assessed related internal controls, and held discussions with officials at activities visited. We performed various audit steps to evaluate internal control structures and compliance with applicable laws and regulations. As part of our audit, we reviewed management's process for evaluating and reporting internal control and accounting systems under the Department of the Defense Management Control Program.

This was the first audit specifically addressing Defense Finance and Accounting Service Norfolk performance of Naval Shipyard financial accounting. Therefore, no followup on prior audits was required.

Exhibit D
Significant Laws and Regulations Included in Review

We considered the following key laws and regulations in planning our review of Naval Shipyard financial accounting at the Defense Finance and Accounting Service Norfolk:

- Chief Financial Officers Act of 1990
- Government Performance and Results Act of 1993
- Federal Financial Management Improvement Act of 1996
- National Defense Authorization Act for Fiscal Year 1998
- Federal Managers' Financial Integrity Act
- Government Management Reform Act of 1994
- Prompt Payment Act
- Debt Collection Act of 1982
- Cash Management Improvement Act of 1990
- Department of Defense Mandatory Procedures for Major Defense Acquisition Programs and Major Automated Information System Acquisition Programs Regulation (DOD 5000.2-R)
- Department of Defense Financial Management Regulation (DOD 7000.14-R)
- Department of Defense Instruction 4000.19, "Interservice and Intragovernmental Support," 9 August 1995
- Office of Management and Budget Circular No. A-123, "Internal Control Systems"
- Office of Management and Budget Circular No. A-127, "Financial Management Systems"
- Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements"
- Defense Finance and Accounting Service Guide to Federal Requirements for Financial Management Systems (Version 2)
- Antideficiency Act (Title 31, U.S. Code, Sections 1341, 1342, 1349-1351, and 1511-1519

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